SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

October Term, 1969

No. 465

EDWARD SERZYSKO,

Petitioner,

—v.—

THE CHASE MANHATTAN BANK,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner, Edward Serzysko, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above entitled case on May 20th, 1969.

Citations to Opinions Below

By a per curiam decision (unreported at this date) which appears as "Appendix A" to the Petition, the Circuit Court of Appeals affirmed the Judgment of the District Court for the Southern District of New York. The opinion of the District Court thus affirmed appears as "Appendix B" to this Petition and is reported at 290 F.Supp. 74 (S.D.N.Y. 1968).

Jurisdiction

The judgment of the Circuit Court was entered on May 20th, 1969. The jurisdiction of this Court is invoked under 28 USCA §1254(1).

Questions Presented

1. Does the right of an Investor Borrower to recover damages resulting from a bank's violation of the margin requirement of Regulation U 12 C.F.R. 221 depend on his degree of sophistication in so far as margin rules are concerned, i.e., is the Congressional purpose in adopting margin requirement for stock speculators better served by limiting such a right of recovery to non-sophisticated investors?

2. Where a lender has made a contract in violation of the margin requirements of Regulation U is the contract completely void as regards lender's rights or may it continue to rely on certain provisions thereof to the disadvantage of the borrower?

Statutes and Regulations Involved

The following Statutes and Regulations are involved:

The Securities and Exchange Act of 1934, Title 15 USCA §78g, §78cc and §78ff; Regulation U, 12 C.F.R. 221, Sections 221.1(a), 221.3(a) and (b)(1). The pertinent portions of the foregoing Statutes and Regulations appear in "Appendix C" to this Petition.

Statement

The Petitioner seeks to recover damages sustained by reason of the Respondent having made loans to him for the purpose of purchasing and carrying registered secur-

ities in excess of the amount of credit permitted under Regulation U (12 C.F.R. 221). Regulation U establishes the percentage of the market price which a bank may loan for the purpose of purchasing or carrying securities registered on a National Exchange.

The District Court although it found that the Respondent had violated Regulation U and the Petitioner was entitled to bring a private cause of action for the violation nonetheless held Petitioner was barred from recovering his damages because of the combination of two elements (1) that he induced the granting of the loans by signing a false "Non Purpose Statement" (that he would not use the proceeds to purchase or carry registered securities), and (2) that he was a sophisticated investor who knew what would constitute violations of the Regulation. This despite the fact that the District Court found that if the Respondent had used the due diligence required of it by the Regulation, it would have discovered the real use to which Petitioner intended to put the loan proceeds.

The Circuit Court affirmed the District Court's judgment adopting its opinion as its own.

Facts

Edward S. Serzysko, the Petitioner, is a Polish immigrant who served as a steward in the Polish Merchant Marine until January of 1943 when he came to the United States (15A).* From 1943 until August of 1952, he served as a steward in the United States Merchant Marine (16A, Exhibit A). In September of 1952, he enrolled as a part time student in the New York Institute of Finance (16A). The New York Institute of Finance is a preparatory school

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* Figures in parenthesis refer to the Joint Appendix in the Circuit Court.

for registered representatives of the New York Stock Exchange (16A). In October of 1953, he was accepted as a registered representative for the New York Stock Exchange and obtained employment as a customer's man with the New York Stock Exchange firm of Cosgrove, Miller & Whitehead (17A). He was with that firm until March of 1958 when he started employment with the New York Stock Exchange firm of Hill, Darlington & Co. (20A). The Petitioner maintained a margin trading account with his employer. In September of 1958, the market value of Petitioner's margin portfolio was approximately $200,000 against which he had a debit balance of $100,000, thus maintaining an equity position of some 50% (20A, 21A).

In 1958, the Petitioner decided to transfer his margin account from his own brokerage firm to a bank (23A). In order to accomplish this, he asked his employer, Mr. Hill, to introduce him to a large bank to which he could move his account (23A). Mr. Hill introduced the Petitioner to Mr. Hardiman who was then the Assistant Vice President of The Chase Manhattan Bank in charge of the bank's branch office at 214 Broadway, New York City (353A, 354A).

On September 3rd, 1958, the Petitioner met Mr. Hardiman at his office at the bank as a result of an appointment made by Petitioner's employer, Mr. Hill (26A). At that meeting Petitioner showed Mr. Hardiman a copy of his "Position Statement" with Hill, Darlington & Co. (26A and Exhibit No. 1). That statement showed that he owned some 28 listed stocks having a market value of approximately $200,000 against which he owed approximately $100,000. At that meeting, the Petitioner told Mr. Hardiman that he would utilize any additional monies the bank might loan him against that collateral to invest in stocks (33A). Mr. Hardiman then invited Mr. Serzysko to have lunch with him and Mr. Hill on September 8th,

1958. At the luncheon meeting, the transfer of Petitioner's account from Hill, Darlington & Co. to the bank was discussed (34A). On the day following the luncheon meeting, September 9th, 1958, the Petitioner and Mr. Hardiman again met at Mr. Hardiman's office in order to work out the details of the transfer of the margin account from the brokerage house to the bank (35A).

Mr. Hardiman on his direct examination testified that he stated that the bank would only make a non-purpose loan (that is, a loan not within the scope of Regulation U) (316A). That it would loan up to 70% of the value of the collateral supplied by Mr. Serzysko and that Mr. Serzysko represented to him that he would not use the proceeds of the loan to buy securities (361A). Hardiman also disclaimed any knowledge that he was aware that Petitioner's account with Hill, Darlington & Co. was a margin account (403A). Hardiman, however, acknowledged that on September 9th, 1958, the day after the luncheon meeting, that he, in the presence of the Petitioner, dictated to his, Hardiman's secretary at the bank, two letters for Serzysko's signature. (Exhibit No. 2 and Exhibit No. 3, 405A). Exhibit No. 2 is a letter addressed to Hill, Darlington & Co. and reads as follows:

> "This is to confirm my verbal instructions to you to deliver to The Chase Manhattan Bank, 189 Broadway Branch, attention of Mr. Harold E. Hardiman, Assistant Vice President, all of the securities listed on the attached statement against payment of your debit balance which I understand is in the neighborhood of $100,500."

Exhibit No. 3 was a letter addressed to The Chase Manhattan Bank, attention Mr. Harold E. Hardiman, Assistant Vice President, and reads as follows:

"I have instructed Hill, Darlington & Co., 40 Wall Street, to deliver to your bank various securities a list of which is attached, valued in the neighborhood of $200,000. Upon delivery of these securities, please pay Hill, Darlington & Co., approximately $100,500 to the debit of my account."

The list of securities mentioned in each of those letters was the "Position Statement" of the plaintiff with Hill, Darlington & Co., dated July 31st, 1958, Exhibit No. 1. That Exhibit is headed "Margin—25—". There could therefore be no doubt that a margin account was being transferred from the brokerage firm to the bank and that Mr. Hardiman was clearly aware of it.

At that September 9th meeting, where the foregoing two letters were dictated by Mr. Hardiman and signed by Mr. Serzysko, Mr. Serzysko also signed in blank a checking account card (Exhibit No. 4), a Promissory Demand Note (Exhibit No. 5) and a so-called "Non Purpose Statement".

On September 12th 1958, after calculating the value of the collateral, the bank loaned Mr. Serzysko $150,000 against the securities which then had a market value of $203,704. $100,623.03 of that $150,000 was paid directly to Hill, Darlington & Co.

The balance of the $150,000 loan, $49,376.97, was deposited to Mr. Serzysko's newly opened checking account with the Bank (46A). The record reflects that the Petitioner used that money to purchase additional securities and caused these new securities to be transferred to the Bank as additional collateral for his loan (49A, 50A, 55A, 62A, 65A, 66A, 69A, 72A, 74A, 79A and 86A). The only checks withdrawn from that account during the years of its existence were either to pay interest to the Bank or to purchase additional registered securities (63A).

Subsequent to the loan of September 12th 1958, the Bank made the Petitioner several additional collateral loans. The dates and the amounts of which are as follows:

Date	*Amount*
October 27, 1958	$21,000.00
July 30, 1959	20,000.00
December 3, 1959	35,000.00
January 6, 1960	12,000.00
January 16, 1961	11,000.00
March 3, 1961	21,000.00

Each of the above loans were evidenced by Notes payable on demand (Exhibits 12, 16, 23, 27, 36, 41). In each of the above instances, the same procedure of signing the Note and the Purpose Statement was followed. From time to time, the Petitioner delivered to the Bank additional stock as collateral for the Petitioner's loans.

All of the collateral with two exceptions, consisted of stocks registered on a national exchange. The two exceptions were $13,000 Burroughs Corporation, 4½% Convertible Subordinate Debentures and $10,000 Vanadium Corporation of America, 4½% Convertible Subordinate Debentures, both sold shortly after their purchase and replaced by registered stock.

On October 2nd, 1961, the Bank changed the format of Petitioner's obligation from Demand Notes to a Time Note. Accordingly, on October 2nd, 1961, the Petitioner's obligations to the Bank were consolidated into a single Note for $270,000 payable in 90 days (382A). That Note was renewed on January 2nd, 1962, and again on April 3rd, 1962 (See Exhibits 52 and 53). In 1962, the stock market entered a period of decline. The Bank pressed the Petitioner to sell of the collateral against the loan some of

which the Petitioner, in fact, did. Finally, between June 5th and June 14th, 1962, with the market declining, the Bank, despite the fact that the Note did not mature until July 3, 1962, sold out all of the collateral in Petitioner's account which resulted in a $14,603.26 deficiency. (Exhibit C, 390A). This deficiency was reduced by a rebate of interest previously discounted in advance to $14,019.49 (Exhibit H).

During the entire period covered by the foregoing transactions, the maximum loan value, as set forth in Regulation U, was either 30% or 10%. As the chart below indicates, each of the Respondent's loans to the Petitioner was in excess of the maximum loan value and in violation of Regulation U if the purpose of the loan was either to purchase or to carry stocks listed on a national exchange.

Date	*Market Value of Collateral*	*Maximum Loan Value As Per Reg. U*	*Total Loan*	*Percentage of Loan to Collateral*	*Percentage of Plaintiff's Equity in Collateral*
9/12/58	$203,704	30%	$ 96,010	46%	27%

The above represents Hill, Darlington & Co. Margin Account.

9/12/58	203,704	30%	150,000	73%	27%
10/25/58	218,951	10%	171,000	78%	22%
7/30/59	274,289	10%	191,000	69%	31%
12/ 3/59	306,674	10%	226,000	73%	27%
1/ 6/60	345,501	10%	238,000	69%	31%
1/16/61	315,526	30%	249,000	79%	21%
3/ 3/61	356,228	30%	270,000	76%	24%
10/ 2/61	302,713	30%	270,000	89%	11%
1/ 2/62	351,227	30%	270,000	77%	23%
4/ 3/62	326,650	30%	270,000	83%	17%

The District Court found that the Respondent violated Regulation U in that it did not use the due diligence required by Section 221.3 of Regulation U which provides in part as follows:

"(a) In determining whether or not a loan is for the purpose specified in § 221.1 or for any of the purposes specified in § 221.2, a bank may rely upon a statement

with respect thereto only if such statement (1) is signed by the borrower; (2) is accepted in good faith and signed by an officer of the bank as having been so accepted in good faith and signed by an officer of the bank as having been so accepted; and (3) if it merely states what is not the purpose of the loan, is supported by a memorandum or notation of the lending officer describing the purpose of the loan. To accept the statement in good faith, the officer must be alert to the circumstances surrounding the loan and the borrower and must have no information which would put a prudent man upon inquiry and if investigated with reasonable diligence would lead to the discovery of the falsity of the statement."

Reasons for Granting the Writ

The holding of the Courts below, that the mere signing of a Non-Purpose Statement by an investor-borrower who is familiar with Regulation U is sufficient to bar his right to recover damages in a private suit for its violation, will frustrate the Congressional purpose by destroying the usefulness of private suits in this area as a supplement to the enforcement of the Securities and Exchange Act.

The Courts below acknowledged that a private cause of action for the violation of the margin requirements of the Securities and Exchange Act of 1934 is to be implied. They further acknowledged that private remedies are desirable in that they provide a necessary supplement to the enforcement of Regulations and Statutes. *J.I. Case Co.* v. *Borak* (1964) 377 U.S. 426.

However, Petitioner's right to recover was denied on the ground that his knowledge of Regulation U combined with his conduct was such that if he were permitted to recover, it would serve to encourage banking violations

of Regulation U rather than to deter them. We submit that this conclusion is unfounded.

Section 78g of 15 U.S.C.A. explicitly states that the margin requirements are fixed for the purpose of preventing the excessive use of credit for the purchase or carrying of securities.

The underlying theory of the statutory margin provisions is to reduce the aggregate amounts of the national credit resources which are directed by speculation into the stock market and to achieve a more balanced use of such resources in commerce, industry and agriculture. See House Committee Report No. 1383, 73rd Cong. 2nd Session. The text of this report reads in part as follows:

> "The main purpose of these margin provisions in section 8 is not to increase the safety of security loans for lenders. Banks and brokers normally require sufficient collateral to make themselves safe without the help of law. Nor is the main purpose even protection of the small speculator by making it impossible for him to spread himself too thinly—although such a result will be achieved as a byproduct of the main purpose.
>
> "The main purpose is to give a Government credit agency an effective method of reducing the aggregate amount of the nation's credit resources which can be directed by speculation into the stock market and out of other more desirable uses of commerce and industry. . . ."

The same thought was put in another way by Mr. Corcoran, one of the drafters of the statute in testimony before the Senate Committee on Banking and Currency. 73rd Cong. 1st Session PT. 15 at page 6494 where he testified:

> "One is to protect the lamb; another, and probably the more important of the two * * * is the protection of the national business system from the fluctuations that are induced by fluctuations in the market, which in turn stem back to this very exquisite liquidity you get when you have a lot of borrowed money in the market."

It thus appears that the dominant purpose of the Act was to protect the economic well-being of the country and the people at large and that a subsidiary purpose was to protect the margin speculator against his own imprudence. The legislative report on the then pending Security and Exchange Act from the House Committee on Interstate and Foreign Commerce H.R. Rep. No. 1383 73rd Cong. 2nd Session. 8(1934) stated:

> "Protection of the small speculator by making it impossible for him to spread himself too thinly will be achieved as a by-product of the main purpose."

Accordingly, it is submitted that this Petitioner's private right of action should be upheld on both theories. Obviously, he is a small speculator who lured by easy credit spread himself so thin that he was wiped out at the first substantial market break. Regardless of that fact, however, he and people like him, be they small speculators or large speculators, sophisticated or not sophisticated, should be encouraged to bring private actions since such actions will further the aim of the statute to restrict speculation and channel money into other more constructive facets of the economy.

The margin prohibitions of the Exchange Act are addressed to persons who "extend or maintain credit * * * for the purpose of purchasing or carrying any security registered on a national securities exchange * * * *" No duties

or restrictions are imposed upon the investor. Thus, in any transaction in which security credit is extended, the statute places the entire burden of observing the margin requirements on the lender, not the investor-borrower. An examination of Regulation U indicates clearly that the sanctions are imposed on the bank. The first sentence of the opening paragraph of Section 221.1(a) reads as follows:

"No bank shall make any loan secured * * *."

The reason why the sole burden of compliance is placed on the lending institution is obvious. That is the only place where the flow of funds may be cut off. To place a burden of compliance on the borrower would only inhibit enforcement of the Act, since it would discourage private suits which are the most effective means of obtaining compliance.

The lower Court in arriving at its decision to bar recovery on the part of the Petitioner says that to permit him or any sophisticated investor who had knowledge of the provisions of Regulation U to recover in a private action would be to encourage rather than discourage deception on the part of investor-borrowers with resulting prejudice to the observance of the margin requirements. It is submitted that this is an inaccurate observation, for to permit recovery by plaintiffs regardless of the extent of their knowledge of the law would put teeth in the good faith requirements of Regulation U. The banks would then be put on notice that they cannot deliberately close their eyes to the requirements of Regulation U and escape its enforcement by going through a ritualistic procedure of asking leading questions as to the proposed use of the funds being borrowed followed by the equivalent of a wink of the eye. If the lower Court's rationale were to stand, banks could loan money in violation of the Regulation with impunity as against civil actions simply by presenting the proposed borrower with a non-

purpose statement for his signature and a copy of Regulation U attached thereto.

Human nature being what it is, speculators will seek out all possible funds with which to speculate. The knowledge that they may eventually have a cause of action against a lender if they suffer losses will not increase their attempts to borrow. At the time the borrowing is made the speculator is motivated solely by the large profits that he foresees. However, if the Bank is made aware that it will bear any losses that the speculator may suffer if it fails to comply scrupulously with the good faith requirement of the Regulation, it will give more than lip service to the requirements of the Act. If the purpose of the Act is to be achieved, i.e., to prevent the infusion of large sums of money in the speculative market at the expense of more constructive elements of the economy, little is gained by confining deterrence to loans to non-sophisticated investors. All speculators must be frustrated in seeking an illegal source of funds with which to speculate. Thus, the dominant purpose of the Act will best be served by making as certain as possible that banks will neither lend to nor conspire with any investors, large or small sophisticated or not.

It may be true that in the eyes of some a borrower who after losing the monies he borrowed, sues the bank for his losses is committing a morally reprehensible act. That, however, does not bar his right to recover if his action furthers an overriding public policy. See *Perma Life Mufflers, Inc.* v. *International Parts Corporation,* 392 U.S. 134 (1968). In the *Perma Life Case,* the plaintiff, whom this Court permitted to recover in a civil antitrust suit, was itself guilty of violating the criminal laws. Nevertheless, this Court felt that overriding public policy required that he be permitted to recover treble damages. In the case at bar, the Petitioner violated no law. The

sole burden of compliance was on the defendant and it must be remembered that the primary emphasis in granting a private right of action under the reasoning of the Court in *J. I. Case* v. *Borak, supra,* is not upon compensation of the plaintiff but upon punishment of the defendant and deterrence of future violations.

Section 78cc, Subdivision (b) Title 15 U.S.C.A., provides that "Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder shall be void (1) as regards the rights of any person who, in violation of any such provision, rule or regulation, shall have made or engaged in the performance of any such contract * * *."

The courts below have interpreted that section by implication to mean that such contracts are somewhat less than void.

The Promissory Note dated April 2nd, 1962 (Exhibit No. 53) which by its terms did not become due until July 2nd, 1962 constituted a contract made in violation of the statute. Nonetheless the courts below sanctioned the Bank's reliance on those provisions of the Note which permitted it to sell plaintiff's collateral before the Note's due date. It is submitted that Congress by the use of the word void meant void for all purposes with regard to the Bank and not just some. The Bank should not have been permitted to rely on provisions in the Note favorable to it and sell out Petitioner's collateral until his obligation fell due under the terms of his contract.

CONCLUSION

For the foregoing reasons, Petitioner prays that a writ of certiorari be granted.

Respectfully submitted,

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